

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Ackerman Analyst: Darrine Distefano Bill Number: SB 846
Related Bills: See Legislative History Telephone: 845-6458 Introduced Date: 02-23-2001
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Attorney, Physician & Surgeon Services at No Charge for Nonprofit Charitable Organization Credit

SUMMARY

This bill would allow a credit for free services provided by an attorney or physician on behalf of any nonprofit charitable organization that helps the poor.

PURPOSE OF THE BILL

The author's staff has indicated that the purpose of this bill is to provide a tax incentive to attorneys, doctors, and surgeons who donate their services to nonprofit organizations.

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective immediately upon enactment. This credit would be operative for taxable years beginning on or after January 1, 2001, and does not contain a sunset date.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAWS

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Current federal and state laws allow a deduction for contributions made to certain charitable organizations. Neither state nor federal laws currently provide a credit or a deduction for the value of services donated to a charitable organization.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

G. Alan Hunter for GHG

04/19/01

THIS BILL

This bill would allow a credit equal to the fair market value of services provided without charge by an attorney or physician and surgeon. The attorney, physician, and surgeon must be licensed to practice in this State. These services must be provided for, or on behalf of, any nonprofit charitable organization located in the State that provides services to the poor.

Any excess credit could be carried over until exhausted.

This bill also specifies that no deduction would be allowed for any services for which the credit was allowed.

IMPLEMENTATION CONSIDERATIONS

This bill uses terms that are undefined, i.e., “physician,” “surgeon,” “poor,” and “fair market value of services”. The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of the credit.

This bill provides a credit for services for, or on behalf of, any “nonprofit charitable organization” that provides services to the poor. Current law allows a deduction for contributions to certain charitable organizations. The author may wish to clarify if this credit is: (1) limited to organizations for which a contribution would also be deductible, (2) extends to other types of nonprofit charitable organizations that provide services to the poor, or (3) applies to both types of organizations.

LEGISLATIVE HISTORY

AB 1689 (Statham, 1993/1994), failed to pass out of the first house, would have allowed a \$5,000 credit to certain health care practitioners who served in "health professional shortage areas."

AB 1172 (Frusetta, 1999/2000), failed to pass out of the first house, would have allowed a 25% tax credit of the taxpayer's expenses for preventive health care provided to farm workers. SB 1416 (Rainey, 1999/2000), died in the Governmental Organization Committee, would have allowed a physician or surgeon to claim a 100% tax credit for the amount that otherwise would be reimbursed by the Medi-Cal program for their services.

OTHER STATES' INFORMATION

Review of **Florida, Illinois, Massachusetts, Michigan, Minnesota,** and **New York** laws found no comparable tax credits. These states were reviewed because of the similarities between California income tax laws and their tax laws.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

This bill would result in revenue losses as shown in the following table:

Fiscal Year Cash Flow Taxable Years Beginning After December 31, 2000 Enactment Assumed After June 30, 2001 \$ Millions		
2001-02	2002-03	2003-04
-\$155	-\$220	-\$230

Note: Since fair market values can represent subjective judgments, this bill could lead to significant abuse and even larger revenue losses.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion:

The revenue impact for this bill will be determined by the fair market value of uncompensated services provided by attorneys, physicians and surgeons, and the tax liabilities of claimants. This analysis assumes that no compensation whatsoever can be received by those professionals for donated services.

Physicians and Surgeons

According to the 1999 U.S. Statistical Abstract, there were approximately 78,502 physicians and surgeons for 1997. This number was grown by Consumer Price Index (CPI) projections, yielding approximately 89,557 for 2001.

For this analysis, it was assumed that the average income tax liability for physicians and surgeons who would take the credit would be approximately \$10,000 (average income of \$200,000 x .05 average marginal tax rate). Further, it was assumed that physicians and surgeons who participate could greatly reduce or eliminate their tax liability by using this credit, leaving a minimum amount of unused credits to future years.

Based on the major incentive effect of allowing a 100% tax credit (despite the loss of compensation), it was assumed that in the first year, 10% of physicians and surgeons would reduce or eliminate their state taxes, generating a loss of \$90 million for tax year 2001. The first-year estimate is less than later years because enactment is assumed after June 30, 2001.

For 2002 and thereafter, it was assumed that approximately 20% would reduce or eliminate their state tax liability, generating a loss of \$184 million for 2002. Losses were grown by CPI projections and adjusted for deductions that would have otherwise been allowed under current law (i.e. material costs).

Attorneys

According to the California Bar Association, there are approximately 137,803 active attorneys in California as of March 1, 2001.

For this analysis, it was assumed that the average income tax liability for attorneys who would take the credit would be approximately \$7,500 (average income of \$150,000 x .05 average marginal tax rate). Further, it was assumed that attorneys who participate could greatly reduce or eliminate their tax liability by using this credit, leaving a minimum amount of unused credits to future years.

Based on the major incentive effect of allowing a 100% tax credit (despite the loss of compensation), it was assumed that in the first year, 2.5% of attorneys would reduce or eliminate their state taxes, generating a loss of \$26 million for tax year 2001. The first-year estimate is less than later years because enactment is assumed after June 30, 2001.

For 2002 and thereafter, it was assumed that approximately 5% would reduce or eliminate their state tax liability, generating a loss of \$53 million for 2002. Losses were grown by CPI projections and adjusted for deductions that would have otherwise been allowed under current law (i.e. material costs).

Combining these two elements, the total revenue loss for tax year 2001 is projected to be approximately \$116 million. The 2001-02 fiscal year loss includes all of tax year 2001 plus 25% of 2002 due to reduced estimated tax payments.

POLICY CONCERNS

Credits generally are provided as a percentage of the taxpayer's actual expenses. This bill would allow a 100% credit for the taxpayer's donated services, which is unprecedented.

This bill does not specify a repeal date or limit the number of years for the carryover period. Credits typically are enacted with a repeal date to allow the Legislature to review their effectiveness. However, even if a repeal date were added, the department would be required to retain the carryover on the tax forms indefinitely because an unlimited credit carryover period is allowed. Recent credits have been enacted with a carryover period limitation since experience shows credits are typically used within eight years of being earned.

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